

AER Briefing JGN Capital Program 16 January 2015

Agenda

- Market expansion unit rates
 - Update on material unit rates
 - Volume variance analysis
 - RY13/14 actual costs
- Zinfra management fee
- Capitalised overheads (including treatment of Total Planning Costs)
- Obsolescence of measurement, control and communication systems

NOTE: all numbers in this presentation are current confidential working estimates and subject to QA and internal approval

Market expansion unit rate development

Areas of agreement

We agree on key methodological choices

- Total ME capex forecast is the aggregate of distinct categories of expenditure
 - New estates
 - Medium-density / high-rise
 - E-G conversions
 - I&C tariff (commercial customers)
 - I&C contract (large industrial customers)
- Mains, services and meters are the key components of connections, and it is important to cost these separately
- Effectively proposing using the methodology in submission with an averaging of components where applicable

Revised Proposal - Mains and Services

Table 1: Mains and Services Unit Rate Development

Component	E-G	New Estates	Medium Density	I&C Tariff	I&C Contract
Contractor	4 year average of volume mix X new contract rates				4 year average
Restorations	4 year average				
Materials	4 year average				
Mgmt Fee	RY14 actuals				
Int. Labour	RY14 actuals				
Quoted Works	RY14 actuals				

- 4 year average is based upon Current Period (RY11, RY12, RY13, RY14)
- Direct overheads included separately
- Management Fee, internal labour and quoted works – only one year of relevant history is available due to changes related to new contract and contract management
- Quoted works under the contracts include: Traffic Control, Major roads works, Night works, additional contract hours, etc.

Revised Proposal - Meters

Table 2: Meter-related Unit Rate Development

Component	E-G	New Estates	Medium Density	I&C Tariff	I&C Contract
Contractor		4 year average			4 year average
Mat.: Gas Meters		4 year average			
Mat.: Hot Water Meters		Based upon latest purchase costs			
Materials: MDL		4 year average			
Int. Labour		RY14 actuals			
Quoted Works		RY14 actuals			

- 4 year average is based upon Current Period (RY11, RY12, RY13, RY14)
- Hot water meters – since product failure, tender responses have lead to increase. Using 12 months average plus increment for new meters costs
- MDL volumes are determined from 4 year historical averages per connections (approx. 21 customers/MDL)
- Direct overheads included separately
- Quoted works include special contractor costs (MDL related only)

Consistency of Volume Mix

Table 3: Volume mix comparison : Contractor Unit Rate

Categories	Initial Submission	3 Yr Avg	RY14 (Actual)	4 Year Average
Services	\$/connection	\$/connection	\$/connection	\$/connection
E-G				
New Homes				
I&C				
MD				
Mains				
E-G				
New Homes				
I&C				
MD				

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- Based upon Volume mix
- Excludes: Direct overheads and other overheads
- Only Contractor costs that are covered by schedule of rates

Proposed method validated by RY14 actuals

Table 4: Comparison of Revised Proposal vs RY14 Actuals

Categories	Revised Proposal	RY14 Actual	%Diff
Services	\$/connection	\$/connection	
E-G	[c-i-c]		-2%
New Homes			0%
I&C			-4%
MD			-4%
Mains			
E-G			3%
New Homes			1%
I&C			-6%
MD			-1%
Meters			
E-G			-19%
New Homes			13%
I&C			-11%
MD - meter			16%
MD - MDL			5%]

ME Unit Rates: Summary

- Based upon JGN submission methodology, recognising amendments proposed in AER Draft Decision
- Utilises (where appropriate) history for current AA period
 - Contractor volume mix
 - Restorations and materials
- Recognises new contract rates and contract terms
- Recognises changes to contractor management and contractor obligations
- Recognises changes to hot water meter costs
- Validated by RY14 actual rates

Zinfra Management Fee

Misinterpretation of FSA clause 15.1

- AER seems to have misinterpreted clause 15.1 in FSA Annexure A, as saying that FSA unit rates include the management fee and margin

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Management Fee explanation

- The contracted unit rates in the FSA are the market-tested unit rates that the AER has accepted as efficient
- As described in AAI appendices 4.1 and 6.8, the Zinfra management fee and management margin relate to programme management and quality assurance functions that Zinfra performs in the south corresponding to functions that JAM itself performs in the north
 - Management services defined in schedule R1.1 in FSA Annexure B: separate from and additional to construction and maintenance work covered by the FSA unit rates
- JGN includes the amounts of the management fee and management margin—and JAM’s equivalent internal labour costs in the north—in building up the fully-costed unit rates that it uses to forecast the cost of new connections and other rate-based work
- Efficiency of management fee and margin validated in AAI appendices 4.1 and 6.8
- Information also provided in a presentation to the AER in November 2013—slides reproduced in attachment A to AAI appendix 4.1

Capitalised Overheads

Capitalised overheads

- AER refers specifically to four components in the context of considering capitalised overheads
 - Direct overheads (pp 6-44 & 45)
 - Total planning costs (TPC) (pp 6-35 & 45)
 - Network planning costs (pp 6-46 & 47)
 - Network control and operational switching (system planning) (in letter of 8 Jan 15)
- Possible confusion because Network planning and Network control and operational switching costs are 100% opex

Direct overheads

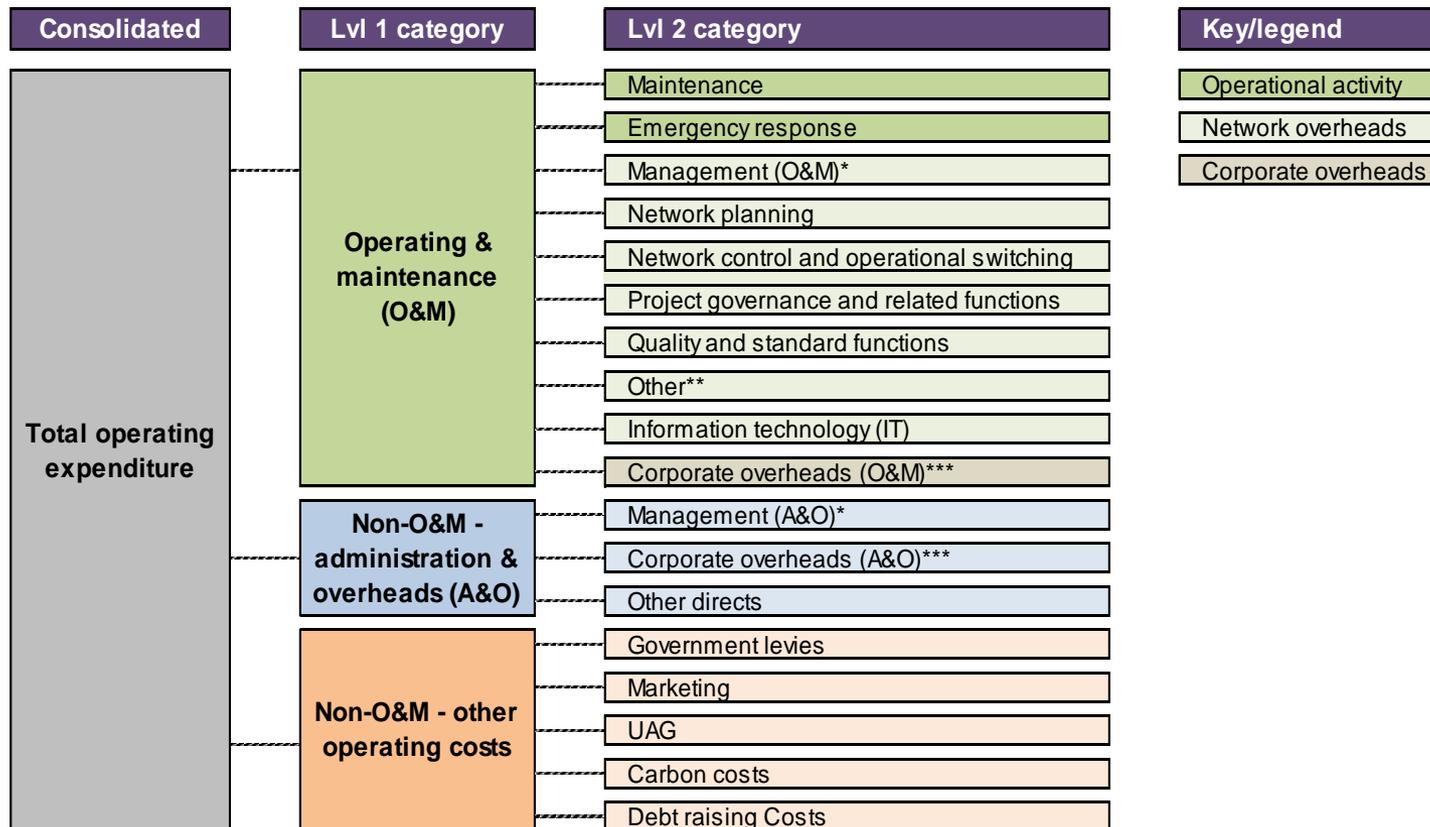
- Direct overheads cover property, stores and non-labour costs attributable to the capex program
- JGN's proposal forecast direct overheads as a percentage of direct capex costs
- AER proposes a base trend approach, discounted because historical market expansion unit rates included direct overheads
 - “Base” is average of actuals for 2012-13 and 2013-14 as a placeholder pending 5 years of historical data
- JGN response
 - 5 years historical data unlikely to be available – CATS rates to 2012 as advised during the draft RIN process
 - Formulating our position – inclined towards base step trend

Total planning costs

- TPC includes the following:
 - front end engineering and design costs
 - site investigation costs
 - project establishment costs, development of detailed project plans, schedules, risk assessments, etc.
 - long lead item specifications
 - tender documentation preparation
 - tender processes
- Essentially project-related but collected together rather than allocated to individual projects
 - Mostly incurred in connection with facilities renewal and refurbishment projects
- Accounted for as projects within facilities renewal and refurbishment in JGN's AA proposal

Network planning and Network control and operational switching costs are opex

Figure 7-1: JGN's operating cost categories



See also AAI appendix 07.1- JGN opex forecast model

Network planning costs

- The network planning function covers:
 - Asset strategy—asset strategy, SIB capex plans, asset management plans, and emergency strategy and contingency plans
 - Asset class management—integrity plans and engineering assessments
 - Asset performance validation—monitoring and validating the technical performance of assets, managing asset risks
 - Program planning processes—business cases and requirement specifications, and analysis and reporting.
 - Maintaining asset records—managing maps, pipeline alignment sheets and engineering records
 - Easement management
- Treated 100% as opex in JGN proposal
 - Consistent with the nature of the function

Network control and operational switching (system planning)

- The network control and operational switching (system planning) function covers:
 - Maintaining meter data—processing service requests from retailers
 - SCADA service (control centre)—management of SCADA communications systems
 - Monitoring and control (control centre)—control room operations
 - SCADA planned and corrective maintenance—performing planned and corrective maintenance on the SCADA systems
- Treated 100% as opex in JGN proposal
 - Consistent with the nature of the function

Draft decision

- AER proposes that TPC be treated as overhead but then disallows on the basis of analysis of
 - network planning costs and TPC (Figure 6-3) and
 - network planning costs and system planning costs (letter 8 Jan)
- JGN response
 - Network planning costs and system planning costs are 100% opex and so are not relevant to a discussion of capitalised overheads
 - TPC is a distinct and necessary component of capital costs
 - separate from the activities that contribute to overheads allocated to capex (which AER approves)
 - mostly associated with facilities renewal and refurbishment and best accounted for in that category

Obsolescence of measurement, control and communication systems

Measurement, control and communication obsolescence

- Three rejected projects relate to asset lifecycle management
 - SCADA (GENe) system replacement (in SCADA)
 - MDL replacement (in meter renewal and upgrade)
 - Metretek field units and central system replacement (in meter renewal and upgrade)
- All three involve systems that are aging
 - susceptible to increasing failure rates
 - components are becoming or are already obsolete
 - suppliers are scaling back/withdrawing support and offering new products
- Consistent with their maturity and stage in the typical technology product lifecycle
- MDL modems and Metretek field units have the added issue of incompatibility with NBN
- JGN has obtained advice from the suppliers in all three cases that supports replacement in the 2015-20 period

Product lifecycle

	Active	Classic	Limited	Obsolete
Sales and manufacturing phase	Complete life cycle services	Limited life cycle services	No services available	
Product	Product is in active sales and manufacturing phase.	Serial production has ceased. Product is often still available for spare part or extension purposes.	Product is no longer available.	Product is no longer available.
Services	Full range of life cycle services is available.	Full range of life cycle services is available. Product enhancements may be available through upgrade and retrofit solutions.	Limited range of life cycle services is available. Spare parts availability is limited to available stock.	No life cycle services available.
Replacement	Migration of limited and obsolete products is usually supported.		Migration to the active product generation is highly recommended.	Migration to the active product generation is the only possibility.

- Metreteks, components of SCADA/GENe, and early version of MDLs are in the “limited” phase and approaching “obsolete”
- MDLs have additional “sole trader” risk